**INVESTMENT INSIGHTS:**

# INTEL CUTS PIMCO TOTAL RETURN FUND FROM 401K, WHAT TO DO?


**Dave Hofer, CFA**
**March 3, 2015**
**dave.hofer@brightwoodventures.com**


Intel recently announced that it will 'close' the Pimco Total Return Institutional Class (Pimco Fund) as an investment choice in plans 'core' offering. If you participate in Intel's 401k plan and have shares in the Pimco Fund, you should have received notice from Intel regarding your options. In this article, I will drill down into the Pimco Fund and compare that fund to other 'core' choices available. For the purposes of this article, I am limiting discussion of choices available inside Intel's 401k plan, excluding any 401k Serplus options. If you'd like more information on Serplus options, feel free to email me. Disclosure: I currently hold share of the Pimco Total Return fund in my Intel 401k.


**Figure1: PTTR 10 Year Total Return (source: www.morningstar.com)**

## How Quickly The Tides Can Turn…

According to Lipper data through 1/31/15, the Pimco Total Return Fund (Pimco Fund) ranked #9 out of 549 funds over 10 years. In the past 5 years the fund was 155 of 549 in category. You'd never know it looking at recent fund outflows. Bill Gross, cofounder of the fund, left last September for Janus funds after months of management turmoil and a few years of lackluster performance. The fund has experienced net outflows for over 20 consecutive months. Investors pulled $8.6B in February and $11.6B in January. Fund assets are less than half of what they were at the peak in April 2013. Intel's announcement noted that Intel did not have 'sufficient confidence' given personnel changes.

Meanwhile, Morningstar gives the fund a four star rating but last September downgraded the fund to 'Bronze'. Morningstar Eric Jacobson noted, "The fund's Bronze Morningstar Analyst Rating reflects Morningstar's high level of confidence in PIMCO's resources and overall abilities but also the uncertainty as to exactly how all of these parts will mesh in the wake of Gross' departure."

## What Will Happen When the Fund 'closes' to Plan Participants on March 23rd?

Intel's disclosure noted that the fund will be 'closed' on March 23 and any assets held in this fund would be transferred to the BlackRock U.S. Debt Index Fund (BlackRock Fund).

If you do nothing, any funds you have in the Pimco Fund will be transferred to the BlackRock Fund. You can retain your Pimco Fund shares if you have a Fidelity BrokerageLink account and transfer funds before March 10th.

## Are There Other Options Besides the BlackRock Fund?

You could rebalance any Pimco Fund shares you have prior to March 23 into another 'core' fund offering. The 'core funds' choices in the 'bond category' are quite limited. Other than the BlackRock Fund, Intel offers the Stable Value fund. If you wanted to gain exposure to other bond asset categories, such as international bonds or emerging market bonds, you would need to add a BrokerageLink account or gain exposure to those types of funds using other non-Intel 401k accounts you hold.

## What Should I Consider Before Making A Change?

The top factor for your decision should be to reconsider how and why you held the Pimco Fund. What role did this fund play in your overall portfolio allocation? Did you hold this fund based on desire for exposure to the US Bond Market only? Were you holding the fund based on Pimco's active management approach? Allocation decisions should be linked to you risk and return objectives and be tailored to your unique circumstances.

That said, let's take a look at the BlackRock Fund and the Stable Value Fund options.

## BlackRock US Debt Fund

The BlackRock Fund is a passively managed index fund that seeks to track the US Bond market index. This makes it significantly different then the Pimco Fund.

The BlackRock Fund is structured as a collective investment trust (CIT) and is subject to banking regulations (and not Investment company regulations). This fund looks to match it's benchmark index using representative sample – this means that it holds a subset of the assets that comprise the index. The fund does not take active positions such as changes to investment duration or credit risk. (The Pimco Fund is actively managed and they do seek to generate excess return over the bond index by taking such positions. Note that much of the Pimco Funds excess returns occurred during the financial crisis of 2007-08.)

The BlackRock Fund's benchmark is the market capitalization weighted Barclay's US Aggregate Bond Index. As such, it will exhibit similar characteristics in terms of types off risk and duration of the underlying assets. For example, the index includes roughly 1/3 US Government securities, 20% corporate bonds and 25% in securitized obligations. The effective duration of the index is roughly 5.5 years. (Duration is a measure of a portfolio's sensitivity to interest rate moves. For example, a small increase in interest rate would cause the value of the portfolio to go down by roughly the duration times the size of the interest rate move.)

As an example of these 'active decisions', if we compare the BlackRock Fund with the current Pimco holdings, we see that Pimco is currently over-weighting US government securities – now over 50% of the portfolio. There are many other techniques Pimco uses to generate 'excess' returns over the benchmark. For example, over the past decade they have effectively used a strategy of 'rolling down' the yield curve. Instead of holding only short duration securities paying low interest they held longer dated issues with higher yield and would sell off these issues as the YTM of the issue fell as the remaining life of the issue fell (as expected when the yield curve is relatively steep).

The BlackRock Fund has a very low expense ratio compared to the Pimco Fund -- .025% vs. .46%. In fact, if we compare the BlackRock Fund to iShares US Bond Fund (ticker AGG), that ETF has an expense ratio of .08%. If you are seeking to gain exposure to the US bond market, this is an efficient approach.

As a final view to comparing the funds we note that the Pimco Fund, when regressed against the returns of the Barclays US Bond Index over 10 years, experience 'Beta' of 1.02, generated 'Alpha' (excess return over the index) of 1.26%. This historical view suggests that the Pimco Fund has experienced systematic risk approximately equivalent to the index.

**Figure 2: MPT Statistics for Pimco Fund, 10 Y ending 2/28/2015**

| | |
|---|---|
| Beta | 1.02 |
| R-Squared | 70 |
| Alpha | 1.26 |
| Sharpe Ratio | 1.15 |

(source: www.morningstar.com)

### Stable Value Fund

This Stable Value Fund invests in high quality bonds and asset & mortgage backed securities wrapped by insurance contracts. These contracts, known as 'GICs', provide 'guaranteed' returns… as long as the underlying issuer (insurance companies) remains solvent. The fund seeks to maintain principal values and generate income returns higher than money market rates. Given the risk (although arguable small) that the underlying insurance companies could become insolvent, the investment should not be considered 'risk free'. (This risk is mitigated in part by virtue of the fact that the fund is engaged across multiple insurers. In addition, the underlying credit rating for these companies is good.)

Intel's 401k site reports the current annualized yield on the Stable Value Fund as 1.8%. Given the characteristics of the fund, we would expect that the risk and return for this vehicle would be lower than the BlackRock Fund.

Is this a good alternative to the BlackRock Fund? Given that the characteristics of this fund are different from BlackRock, I would look at two elements: 1) the impact to your overall portfolio allocation, and 2) whether you want to take an active position on trying to time any short to intermediate term interest rate moves. The allocation decision is a function of your unique situation and thus beyond scope of this article. Let's explore the second question. Let's say you believe the US economy is going to pick up steam from the current 2.4% real GDP growth rates and that you believe interest rates will rise during the period. Given that the BlackRock Fund is passively exposed to intermediate term issues, significant increases in interest would cause the bond fund principal to be re-priced down. In this scenario, one may argue that a shift to the Stable Value Fund could help to mitigate the impacts. It should be noted that, although principle value would go down in an rising rate environment, income return is of course moving up.

<u>Disclosure</u>

This article should not be considered investment advice, given that any advice should consider your personal financial situation. Investing is not without risks and there is no assurance future returns will match historical.